



Y2K Newsletter

MMillennium

May 29, 1998

Volume 1, No. 5

Results of Nearly 7 Months of On-site Exams Reported

With just about a month remaining in the current second round of Year 2000 on-site examinations, OTS had through May 22 started a total of 1007 exams, completed 897 and assigned ratings for 759. The ratings generally are consistent with earlier findings – renovations efforts are proceeding apace; some testing or validation has begun; and institutions are taking steps to firm up testing plans.

Of the total exams completed so far, OTS rated 633 institutions “satisfactory,” 120 “needs improvement,” and 6 “unsatisfactory.” Unsatisfactory findings were attributable to late starts or insufficient progress on the Year 2000 project, even after receipt of an off-site exam report. Deficiencies noted by examiners in the six institutions ranged from an almost complete lack of awareness of the computer date change problem to some awareness but no completion of an inventory or Year 2000 action plan.

Most institutions rated “needs improvement” are serviced by independent data centers, or service providers. Some examples of deficiencies found include: lack of comprehensively developed assessments and action plans to allow effective tracking of an institution’s progress; weak vendor tracking; and insufficient personnel devoted to the Year 2000 effort. In some cases, examiners found that institutions are involved in a pending conversion to another service provider for critical systems in 1999, a factor that leaves relatively little time for testing either the new systems if conversion occurs on schedule, or testing with the existing vendor if the conversion were delayed.

OTS expects that the deficiencies resulting in the “needs improvement” category can be overcome by the institutions in time to achieve Year 2000 readiness. Even those currently rated “unsatisfactory” have an opportunity to succeed if they substantially accelerate their activities.

A group of 33 thrifts representing a large percentage of the industry’s total assets have their own in-house programming operations and are directly responsible for code renovation and testing. With just three exceptions, examiners found no weaknesses in plans and implementation to warrant a less than satisfactory rating. In the three cases, the institutions completed the Awareness and Assessment phases in a timely manner and are in Renovation and Validation for many of their systems. The agency’s major concern is that a third party may not be able to deliver a needed product early enough for the thrift to conduct testing within the FFIEC testing milestones.

The Y2K Newsletter is published by the Office of Thrift Supervision in a continuing effort to prepare ourselves and the industry we supervise to meet the challenges of the next millennium. Any comments, suggestions or requests for topical information should be addressed to your OTS Regional representative listed elsewhere in this newsletter.

So far, the agency has issued one supervisory agreement with an institution receiving an unsatisfactory rating, and several other enforcement actions are pending. The agreement sets a course of action the thrift must follow in its remediation effort. OTS has emphasized that enforcement is not the goal, but a means to get thrifts falling behind the renovation effort to move toward meeting the milestones.

The second round of examinations is expected to be completed by June 30. A new round of examinations focused on testing will begin in September and finish up around the end of April 1999. Some institutions will already be in the implementation phase, so examiners will also be looking at that activity. The information on testing, as well as reports on other aspects of OTS' activities in Year 2000 conversion, were reported to staff members of the House and Senate Banking committees as part of the series of periodic updates the banking agencies and National Credit Union Administration must give Congress.

June 2 New York Conference Agenda Set

"Facing the Year 2000 Challenge Together" is the theme of the Tuesday June 2 conference to be held at the Chase Manhattan headquarters in Manhattan, cosponsored by the bank and OTS' Northeast Region. Registration will be at 1 p.m., and the program will commence at 1:30 p.m. with opening remarks by Robert Albanese, OTS Northeast regional director. The conference will continue through the afternoon, to be followed by a reception starting at 6:30 p.m.

Keynote speaker will be John Koskinen, assistant to President Clinton and chair of the President's Council on the Year 2000 Conversion. His remarks will focus on the federal perspective of the Year 2000 challenge. Another key speaker will be Cindy Sprunger, who is senior professional staff with the House Banking Committee and heads a staff team concentrating on Year 2000 issues. Other speakers will include representatives of Chase Manhattan and service providers ALLTEL Corp.; EDS; Fiserv, Inc.; Financial Services, Inc.; NCR Corp.; Bellcore; Key Services Corp.; COCC; and NYCE Corp. There will be a representative of Bell Atlantic to give the utility's view of the challenge, and speakers from the Federal Reserve Bank of Boston, Long Island Savings Bank and Centreville Bank to add the thrifts' flavor to the proceedings.

Two More Guidance Papers Issued by FFIEC

In mid-May, the Federal Financial Institutions Examination Council (FFIEC) issued guidance on two more key elements of Year 2000 preparation – contingency planning to mitigate risks and responding to customer inquiries regarding the Year 2000 date change. The two statements follow earlier ones on project management, business risk, vendor management, corporate customers and testing. All of the guidance statements are available on the FFIEC web site through the OTS web site at www.ots.treas.gov.

Thrift, banking and credit union regulators, working together, developed the guidance, pointing out that contingency planning is necessary to ensure that an institution's mission critical functions will continue if one or more systems fail as a result of the millennium changeover. The statement urges a board of directors and senior management of a financial institution to place a high priority on developing, validating and implementing the institution's Year 2000 contingency plan. The plan must take into account the impact of external systems, including those of service providers, other financial institutions, customers, business partners and infrastructure providers, such as those that supply power and telecommunications. Contingency planning will vary according to the size and complexity of the thrift, bank or credit union.

Earlier guidance addressed contingency planning pertaining to vendor management. The new guidance covers contingency planning as it applies to renovation, testing plans, continuation of automated information systems and, most important, the continuation of all aspects of core business processes. There are four phases in contingency planning:

- Developing organizational planning guidelines for the institution to identify core business processes and prioritize business risks;
- Completing a business impact analysis on each core business process and defining and documenting Year 200 failure scenarios;
- Preparing a contingency plan for each core process that identifies contingency options and implementation modes and establishing trigger dates to activate the contingency plan; and
- Validating the institution's contingency plans through an independent review of the feasibility of the plans and periodically testing the plans to ensure that changes in the institution's year 2000 project plan and actual events are incorporated into the plans as appropriate.

The institution's Year 2000 Business Resumption Contingency Plan should not be viewed as a static document, but as a process that should be reviewed, updated and validated on a continuous basis

Customer Awareness Program

Regulators expect financial institutions to develop a customer awareness program that responds to questions and communicates with customers. Examiners will review the adequacy of such programs during on-site Year 2000 exams.

The FFIEC statement says, "Effectively responding to customer inquiries also is in the best interests of the financial institution. It can serve to disclose to customers the institution's Year 2000 efforts and to provide information on how products and services used by those customers may be affected by the institution's readiness efforts. Ultimately achieving Year 2000 readiness and ensuring that customers and business partners receive adequate information about an institution's efforts is and must be the responsibility of a financial institution's directors and officers. Management is in the best position to know how the Year 2000 date change will affect an institution's operations, strategies, resources and exposures, and how and when it would be best to respond to the specific concerns of its customers."

An institution should consider the issues likely to be of interest to customers as they formulate their awareness programs. Some of the issues may be:

- Safety of money in customers' accounts;
- Access to their funds, such as via ATMs, debit cards, telephone lines or Internet and what alternative access would be available in case of a disruption;
- Available information on the institution's project management and contingency plans;
- How the institution would assist any customer affected by incorrect automatic transactions, such as direct deposit and direct debit initiated by the institution or thrift parties;
- Whether customers might not receive proper credit for loan payments;
- The institution's record keeping practices; and
- The types of records customers should maintain prior to and after January 1, 2000.

The guidance advises that institutions should identify customers, including depositors, borrowers, fiduciary clients and others, who ought to be proactively informed of efforts to

address business risks. Among the methods suggested are brochures, toll-free hotlines and utilizing Internet sites to inform customers about preparedness. FFIEC is developing a brochure which is to be ready in June.

Financial institutions need to consult with their legal counsel before issuing information describing the status of year 2000 readiness efforts, and they are reminded they cannot publicly reveal the contents of federal supervisory agency examination reports or reviews of the institution or any service provider or software vendor, including the confidential year 2000 summary ratings contained therein. They also should avoid any statements that indicate or imply that their readiness has been approved or certified by a supervising agency.

Compliance with Consumer Laws, Another Y2K Issue

Many laws and regulations that provide consumer protections have time-sensitive requirements, such as notice obligations, that may pose Year 2000 risks. OTS' West Region recently compiled a list of these and included the time factors and other issues involved in each. The West Region also points out that lack of compliance with consumer laws can expose institutions to potential legal liability, financial exposure, lost revenues, unnecessary costs to fix problems and a host of customer goodwill, corporate image and other public relation problems. Institutions also can face significant potential liability if Year 2000 problems result in breaches of contractual obligations or violations of state laws, such as the Uniform Commercial Code.

Institution officials also should remember that many compliance systems are connected to other systems within and outside the institution and that all of them must be compatible and Year 2000 compliant. For example, teller operations that often are supported by personal computers must be compatible with back room operations that may depend on mainframe computers for support. Nor can institutions ignore Year 2000 issues involving third parties on linked systems. As an example, most automatic teller machine cards connect to machines at other institutions, to point-of-sale terminals and credit card accounts. Likewise, the automatic clearing house system is interconnected.

Because each institution's operating systems are unique, it is impossible for OTS to specify all areas of exposure within your institution. Therefore, the agency expects each institution to initiate steps to address its Year 2000 risk exposure regarding compliance with the various consumer, compliance, nondiscrimination and public policy laws, rules and regulations, and take timely and appropriate corrective action to remedy identified risks. To minimize risk, thrifts need to include compliance systems in their Year 2000 planning, including contingency planning. Moreover, planning and testing must involve departments with related systems. Institutions must also ensure that third-party systems linked to theirs will be compliant in time to adequately test their compatibility.

Following are the relevant rules and regulations and a sampling of Year 2000 issues inherent in them:

Electronic Fund Transfers Act
(Regulation E)

Timing of change-in-terms
notices

Date and balance calculation on
ATM receipts

Expedited Funds Availability
Act (Regulation CC)

Timing of periodic
statements

Calculation of hold periods
Determination of hold exceptions, including returned item and overdraft exceptions
Release of holds

Regulation J

Need of system and participants to be Year 2000 compliant and compatible
Timing of payment or return of an item
Monitoring for overdrafts

Reserve Requirements (Regulation D)

Calculating reserve requirements
Calculating number of withdrawals on money market deposit accounts
Calculating days and penalty amounts for early withdrawals.

Truth in Savings (Regulation DD)

(Teller Platform)

Timing of initial disclosure if depositor did not come into institution

Calculation of annual percentage yield
Disclosure of maturity date

(Back Operation)

Capture of transactions during the period
Calculation of number of days in period and interest earned
Calculation of interest earned and annual percentage yield earned

Bank Secrecy Act (BSA)

Capture of data for Currency Transaction Report
Compatibility of electronic CTR filing systems

Timing of CTR report filing
Monitoring multiple transactions, branch cash reports and patterns of activity for suspicious activities
Accuracy of wire transfer records

Foreign Assets Control

Monitoring for restricted transactions

Insider Credit (Regulation O)

Monitoring for overdrafts

FDIC

Calculation of FDIC insurance premiums

IRS Regulations

Withholding calculation, data capture and timely reporting of interest paid
Timing of distribution and reporting on IRAs, SEPs, Keoghs, etc.

Truth in Lending Act (Regulation Z)

Calculation of APR, total payments, finance charge and payment stream
Rescission period
Late fee calculation

TILA (OTS Mortgage Regulations and Reg Z)

Calculation of historical example
Disclosure of maximum payment example and calculation
Calculation of adjustment dates

OTS Mortgage Regulations

Calculation of late charges and grace periods

Real Estate Settlement Procedures Act (RESPA)

Timing of good faith estimate
Calculation of information for HUD-1
Calculation of initial and annual escrow amounts

IRS Regulations

Data capture, and timely and accurate reporting of interest paid

Equal Credit Opportunity Act (Regulation B)

Capture of data for credit score
 Timing of notification of decision date
 Timing of notice of incomplete application
 Explanations of commitments

Home Mortgage Disclosure Act (HMDA)

Capture of loan application and action taken
 information
 Transfer of information from loan origination to
 reporting system
 Timely submission of reports.

Fair Credit Reporting Act

Accuracy of information reported
 Timing and handling of disputes of information
 reported
 If consumer reporting agency, furnishing inaccurate
 consumer reports

Unfair Credit Practices rule

Pyramiding late charges

Community Reinvestment Act (CRA)

See HMDA
 Accurate reporting of small
 business, consumer and
 community development lending

Consumer Leasing Act (Regulation M)

Calculation of date and total
 amount of periodic payments
 Calculation of capitalization,
 residual value, depreciation

Fair Debt Collection Practices Act

Collection notices and
 delinquency notices
 Accuracy of information,
 especially automated default
 reports

Flood Disaster Protection Act

Timing of determination and
 notice
 Integrity and compatibility of
 electronic determinations and
 records

HUD Homeownership Counseling

Timing of notice of availability
 of counseling

Miscellaneous

Forms may need to be changed
 because of "19" preprinted for
 dates
 Tracking reports
 Expirations of commitments

Bank Protection (12 C.F.R. &568)

Alarms, cameras, vault, card
 keys, customer access
 identification

Handy Time Line for Checking Progress

Here is a time line of remaining milestones that thrifts can use to compare with target dates for testing they have established or are modifying.

<u>Date</u>	<u>Thrift</u>	<u>Vendor</u>	<u>Service Provider</u>	<u>Reference</u>
By 6/30/98	Remediation	Remediation of products	Remediation of products ongoing	

	Implement customer due diligence program	ongoing		FFIEC 3/98 Customer Impact Guidance
	Develop, implement written Year 2000 testing strategies	Same as thrifts	Same as thrifts	FFIEC 4/98 Testing Guidance
By 9/1/98	Remediation ongoing	Same as thrifts	Same as thrifts	
	Thrifts processing inhouse have begun testing internal mission critical systems	Internal testing of mission critical systems has begun	Internal testing of mission critical systems has begun	
By 9/30/98	Remediation ongoing	Same as thrifts	Same as thrifts	
	Customer impact assessments complete, reported to directors			FFIEC 3/98 Customer Impact Guidance
By 12/31/98	Institutions processing in-house have programming changes and internal testing of mission critical systems substantially complete	Same as thrifts	Same as thrifts	FFIEC 4/98 Testing Guidance
	Institutions reliant on vendors or service providers ready to test with them	Vendors ready to test with customer	Service providers ready to test with customers	
By 3/31/99	Testing with vendors or service providers substantially complete	Testing with customer substantially complete	Testing with customers substantially complete	
	External testing with material third parties should have begun			
By 6/30/99	Testing of mission critical systems complete	Testing of mission critical customer products complete	Testing of mission critical customer products complete	
	Implementation of compliant mission critical systems substantially complete	Implementation of compliant mission critical customer systems substantially complete	Implementation of compliant mission critical customer systems substantially complete	
Ongoing	Report to directors at least quarterly			FFIEC 12/97 Guidance on Business Risk
	Vendor, service provider due diligence & contingency monitoring			FFIEC 3/98 Vendor, Service Provider Due Diligence Guidance

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